WisdomTree Yield Enhanced Canada Aggregate Bond Index ETF

In more normal interest rate environments, the core of an investor's bond portfolio could be counted on as a way to generate income and help mitigate volatility[1] from other riskier asset classes. However, in today's fixed income markets, the Canadian Aggregate Bond Index struggles to provide adequate income with yields near historic lows. For investors seeking income, concentrating positions in Canadian Treasuries appears to be contrary to their investment objectives. In response, many investors have increasingly looked outside of the Canadian market to boost income potential. While we also subscribe to this view, doing so ultimately incurs additional risk. In response to these challenges, we believe looking within the Bloomberg Barclays Canadian Aggregate Index (CAD Agg) to potentially enhance income could also provide value.

In order to address investors' desire for income, WisdomTree worked with Barclays to take a different approach to Canadian fixed income. The Bloomberg Barclays Canadian Aggregate Enhanced Yield Index (CAD Agg Enhanced Yield) uses a rules-based approach to reallocate across sub-components in the CAD Agg seeking to enhance yield, while maintaining a similar risk profile. Yield can typically be increased by shifting exposure along any of a number of different risk dimensions, including sector exposure (treasury, government related, credit), interest rate risk (duration), and credit risk.

THE INDEX'S THREE STEP METHODOLOGY:

1. Divide the CAD Agg into 12 Subcomponents
2. Develop and Apply Constraints
3. Determine Index Weights

---

[1] A measure of the dispersion of actual returns around a particular average level. Generally, the higher the volatility, the riskier the security.

WisdomTree®

1. Divide the CAD Agg into 12 Subcomponents

In step one, the CAD Agg is decomposed into 12 buckets across sector, maturity[2] and credit quality[3]. While each component retains suitable size for investability and liquidity[4] purposes, each bucket may present a unique combination of risk and reward.

		Years to Maturity		
		1-5 Years	5-10 Years	10+ Years
Sector	Treasury	Treasury 1-5	Treasury 5-10	Treasury 10+
	Credit	Credit 1-5 A & Above	Credit 5-10 A & Above	Credit 10+ A & Above
		Credit 1-5 BBB	Credit 5-10 BBB	Credit 10+ BBB
	Gov Related	Gov Related 1-5	Gov Related 5-10	Gov Related 10+

[2] Maturity: the amount of time until a loan is repaid.
[3] Credit quality: A measure of a borrower's potential risk of default. Credit Rating determined using Bloomberg's index rating methodology.
[4] Liquidity: The degree to which an asset or security can be bought or sold in the market without affecting the asset's price.

WISDOMTREE®

2. Develop and Apply Constraints

The following constraints are added, which serve to control risk and concentration while limiting turnover:

+ **Tracking Error Constraints:** Tracking Error Volatility (TEV)[5] of the CAD Agg Enhanced Yield Index relative to the CAD Agg would be less than 0.35% (35 basis points [bps]) each month.

+ **Duration Constraints:** The duration of the Index cannot be more than one year greater than that of the CAD Agg.

+ **Sector and Subcomponent Constraints:** The weight of major and minor sectors (treasuries, credit, and government related) cannot deviate by more than 20% from their weights in the CAD Agg. The total notional weight of the Baa subcomponents (Credit 1-5 Year Baa, Credit 5-10 Year Baa, Credit 10+ Years Baa) cannot deviate from their weights in the CAD Agg by more than 20%.

+ **Turnover Constraints:** Portfolio turnover due to monthly rebalancing[6] is capped at 5%. When this condition cannot be met, the turnover limit is increased incrementally by 1% until a solution is found.

3. Determine Index Weights

On a monthly basis, weights of the Index are reallocated across the 12 subcomponents to maximize yield, while adhering to the four constraints. These weights are then applied at the individual issue level, such that the weight is the product of the subcomponent's determined weight and the security's weight within the subcomponent.

For example, if a treasury note maturing in three years has a 10% weight within the 1-5 Year Treasury subcomponent, the calculated weight of 12% allocated to the Treasury 1-5 subcomponent would result in a weight of 1.2% at month-end. Returns and statistics are calculated based on the constituents for the coming month. The CAD Agg Enhanced Yield is rebalanced each month.
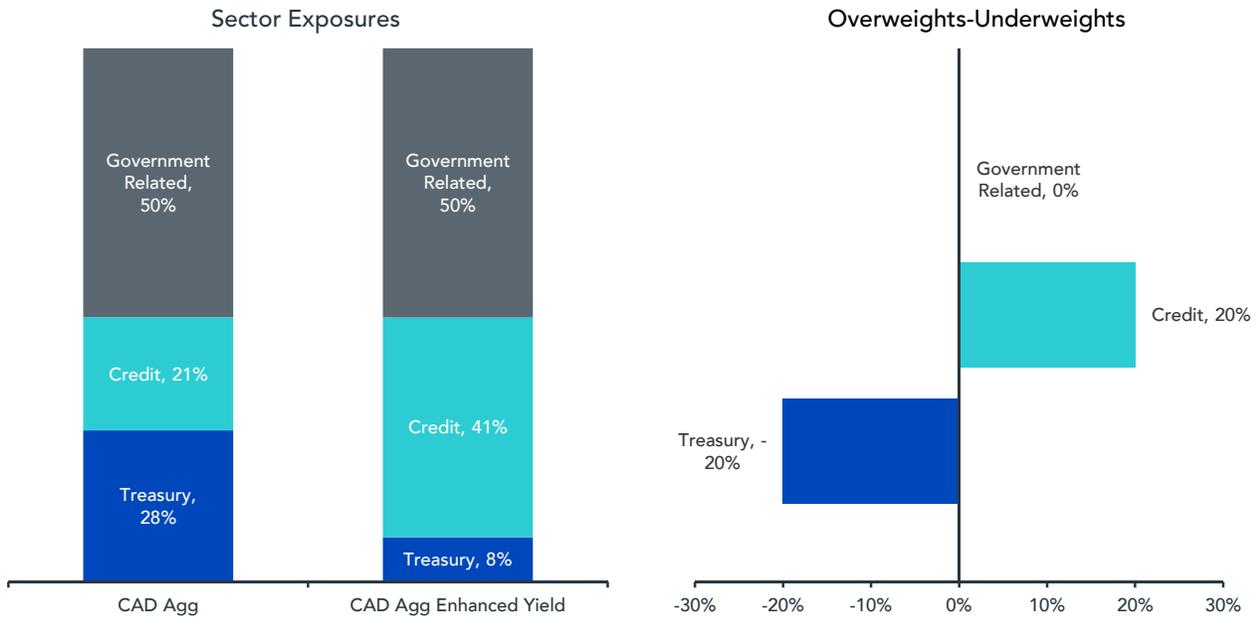
THE RESULT

As of 6/30/2018, the CAD Agg Enhanced Yield delivers an additional 44bps of yield[7] relative to the CAD Agg with a similar volatility profile. In our view, this mechanical approach enhances the desirable characteristics of the CAD Agg, while also enhancing the income potential of the strategy. For investors needing to hit minimum income targets, this modification of the CAD Agg could help them achieve their objectives. For managers currently concerned about the high-yield bond market, this approach also provides higher income potential in an investment-grade portfolio.

---

[5] Tracking Error Volatility: the volatility of the difference between the performance of a portfolio and its benchmark. In this case, the portfolio is the CAD Agg Enhanced Yield Index.
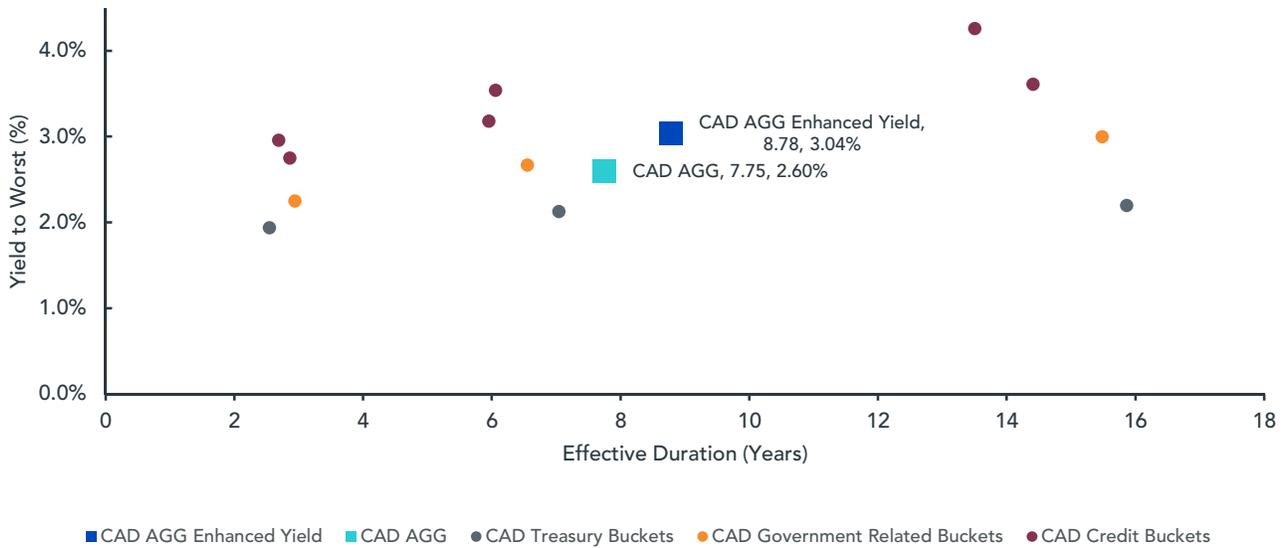[6] Rebalance: An index is created by applying a certain set of selection and weighting rules at a certain frequency.
[7] Yield: Calculated as the income return on an investment and refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

WisdomTree®

SNAPSHOT OF THE CAD AGG ENHANCED YIELD RELATIVE TO THE CAD AGG [As of 6/30/2018]

Sector Exposures

	CAD Agg	CAD Agg Enhanced Yield
Government Related	50%	50%
Credit	21%	41%
Treasury	28%	8%

Overweights-Underweights

Government Related	0%
Credit	20%
Treasury	-20%

Yield and Duration Comparison, as of 6/30/2018

CAD AGG Enhanced Yield, 8.78, 3.04%

CAD AGG, 7.75, 2.60%

Yield to Worst (%) vs Effective Duration (Years)

■ CAD AGG Enhanced Yield   ■ CAD AGG   ● CAD Treasury Buckets   ● CAD Government Related Buckets   ● CAD Credit Buckets

Source: Bloomberg, WisdomTree, as of 6/30/2018. You cannot invest directly in an index. Yield to Worst: Portfolio Yield to Worst represents the weighted average yield to worst of a fund's Investments in fixed income securities as of a specified date. Yield to Worst is the rate of return generated assuming a bond is redeemed by the issuer on the least desirable date for the investor.

WISDOMTREE®

HOW TO IMPLEMENT WITHIN A PORTFOLIO

Incorporating the WisdomTree Yield Enhanced Canadian Aggregate Bond Index ETF (CAGG) into a broad-based fixed income portfolio can be beneficial not only as a replacement, but also as a complement. Using CAGG to represent core bond holdings, or blending in CAGG in varying proportions could have a meaningful impact on a portfolio's yield without drastically altering existing risk and exposure characteristics.

The Index-level data below demonstrates the differences in varying proportions of the CAD Agg and CAD Agg Enhanced Yield.

YIELD AND DURATION FOR BLENDS OF CAD AGG AND CAD AGG ENHANCED YIELD [6/30/2018]

	100% CAD Agg	75% CAD Agg / 25% CAD Agg Enhanced Yield	50% CAD Agg / 50% CAD Agg Enhanced Yield	25% CAD Agg / 75% CAD Agg Enhanced Yield	100% CAD Agg Enhanced Yield
Yield	2.60%	2.71%	2.82%	2.93%	3.04%
Duration	7.75	8.01	8.27	8.52	8.78

SECTOR BREAKDOWN FOR BLENDS OF CAD AGG AND CAD AGG ENHANCED YIELD [6/30/2018]

	100% CAD Agg	75% CAD Agg / 25% CAD Agg Enhanced Yield	50% CAD Agg / 50% CAD Agg Enhanced Yield	25% CAD Agg / 75% CAD Agg Enhanced Yield	100% CAD Agg Enhanced Yield
Treasury	28%	23%	18%	13%	8%
Credit	21%	26%	31%	36%	41%
Government Related	50%	50%	50%	50%	50%

INTRODUCING WISDOMTREE YIELD ENHANCED CANADA AGGREGATE BOND INDEX ETF

To provide tradable access to the CAD Agg Enhanced Yield, WisdomTree launched CAGG. CAGG offers the opportunity to enhance the income potential of a core bond portfolio, while continuing to benefit from the diversification of a multi-sector portfolio.

WISDOMTREE®

Quick Facts

Ticker: CAGG

Class: Non-Hedged

Exchange: TSX

Management Fee: 0.18%

Management Expense Ratio: 0.20%

Structure: ETF

Objective: The Fund seeks to track the price and yield performance, before fees and expenses, of the Bloomberg Barclays Canadian Aggregate Enhanced Yield Index.

Primary Exposure: Canadian dollar denominated, investment-grade fixed income

At WisdomTree, we do things differently. We build our ETFs with proprietary methodologies, smart structures and uncommon access to provide investors with the potential for income, performance, diversification and more.

Publication date: 08/30/2018